

Chapter 18
Category 11m
Owner Did Not Properly
Calculate Utility Allowance

Definition

This category is used to report noncompliance with the utility allowance requirements outlined in Treas. Reg. §1.42-10. An allowance for the cost of any utilities, other than telephone and cable¹, paid directly by the tenant(s) is included in the computation of gross rent under IRC §42(g)(2)(B). A separate estimate is computed for each utility and different methods can be used to compute the individual utility allowances. The utility allowance is computed on a building-by-building basis. The maximum rent that may be paid by the tenant must be reduced by utility allowance(s) obtained in the following manner.

1. If a building receives assistance from Farmer's Home Administration (FmHA), or tenants in the building receive FmHA housing assistance, then the FmHA utility allowance is used for all the rent restricted units in the building.
2. Buildings that are both HUD regulated and FmHA assisted use the FmHA utility allowance for all the rent restricted units in the building.
3. HUD regulated buildings use the HUD utility allowances for all rent restricted units in the building.
4. If a building is neither FmHA assisted nor HUD regulated, and no tenants receive FmHA assistance, the units occupied by one or more tenants receiving HUD rental assistance payments must use the applicable public housing authority utility allowances established for the existing Section 8 housing program. Other rent restricted units in the building use the public housing authority allowance as well, unless a utility company estimate is obtained and then that estimate becomes the appropriate allowance *for the building* (except for the HUD assisted units which will continue to use the public housing authority allowance).
5. If neither the building nor tenants are subject to the rules described in 1-4 above, then the local public housing authority (PHA) allowance is used. However, if an estimate is obtained for any unit from a utility company, that estimate is used as the utility allowance for all similar units in the building.

**Utility
Company
Estimates**

Under Treas. Reg. §1.42-10(b)(4)(ii)(B), any interested party (tenant, owner, or state agency) may request a written estimated cost of that utility for a unit of similar size and construction *for the geographic area in which the building is located*. This estimate becomes the appropriate utility allowance for all rent-restricted units of similar size and construction in the building. The local utility estimate is not available to buildings/tenants subject to Rural Housing Service or HUD jurisdiction.

¹ Cable service is not a utility. It is a discretionary cost, similar to telephones, and is not included in the gross rent computation.

Until further guidance is provided through administrative ruling or guidance², the election to use a local utility company estimate is permanent; i.e., the taxpayer cannot switch back and forth between the local PHA and utility company estimates.

State agencies have reported that although utility companies may be willing to provide interested parties (owner, tenant, state agency) with an initial estimate, utility companies are increasingly unwilling to provide estimates on an on-going basis. Accordingly, until further guidance is provided through administrative ruling or regulation, the Service will not challenge the owner's return to using the applicable PHA utility allowance, provided that:

1. The taxpayer has demonstrated to the state agency that the local utility company was unwilling to provide an updated estimate, and
2. The owner has *written* approval from the state agency to use a mutually agreed upon utility allowance.

Using Public Housing Authority Estimates

State agencies have reported that the local PHA utility allowances do not always reflect a fair approximation of actual utility costs for such buildings. Accordingly, until further guidance is provided through administrative ruling or regulation, taxpayers may calculate utility allowances for the rent-restricted units in the building based upon an average of the actual use of similarly constructed and sized units *in the building* using actual utility usage data and rates, provided that the taxpayer has written approval from the state agency.

If an owner computes the utility allowance estimates based on the expected or historical use by the LIHC buildings/units, the estimate must be calculated in a reasonable manner and *contemporaneously* documented³ to show how the estimate was determined. State agencies should review the methodology used to calculate the estimate for reasonableness, and ensure that the estimate is computed accurately.

Updating Utility Allowances

If the applicable utility allowance for a unit changes, the new utility allowance must be used to compute gross rents of LIHC units due 90 days after the change. As a practical matter, utility allowances are usually reviewed when HUD updates the Area Median Gross Income (AMGI) for the location (which may change the allowable gross rent). If the applicable utility allowance for a unit changes, the new allowance must be used to compute gross rents due 90 days after the change.

In Compliance

Low-income housing projects are in compliance when the appropriate utility allowance is used, the utility allowance is properly calculated, and rents are reduced for a utility allowance when utilities are paid directly by the tenant.

Example 1: Utility Allowance Increases

² Chief Counsel has opened a regulation project. See Federal Register/Vol. 70, No. 209. The regulation number is 1545-BC22 and the sequence number is 2597. This chapter will be updated when the regulation is revised.

³ IRC §6001 requires all taxpayers to keep adequate records to support the items represented on their tax returns, including utility allowances.

The maximum gross rent is \$500. The owner charged rent of \$450, which reflected a \$50 utility allowance; i.e., \$450 rent + \$50 utility allowance = \$500 gross rent. The annual utility allowance estimate increases to \$75. The owner reduces the rent to \$425 based upon the increased utility allowance of \$75; for a gross rent of \$500 (\$425 + \$75 = \$500).

Example 2: Local Utility Company No Longer Provides Estimates

The owner used estimates of utility use as provided by the local utility company to determine the utility allowance. The owner asked the local utility company for an updated estimate of use by similar units in the local area. The utility company informed the owner that they no longer provide estimates. With the state agency's approval, the owner begins using the current PHA allowance.

Example 3: Public Housing Authority's (PHA) Utility Allowance is Outdated

The owner used estimated utility use as provided by the local utility company to determine the utility allowance. The owner reviewed the allowance and asked the local utility company for an updated estimate of use by similar units in the local area. The utility company informed the owner that it no longer provides estimates. The owner and state agency agree that the PHA's utility allowance did not reflect current costs. With the state agency's approval, the owner begins using a utility allowance based on the actual utility use for the LIHC building. The owner may continue to use actual utility costs to compute the utility allowance until further guidance is provided through administrative ruling or regulation.

Example 4: Increased Utility Allowance Does Not Cause Rent to Exceed Limit

The maximum gross rent limit is \$500, but the owner charged \$415 rent and a \$50 utility allowance for a total of \$465. The utility allowance increases to \$60 the next year. The owner makes no adjustment to the rent. The owner is in compliance. The owner is charging \$415 rent and a \$60 utility allowance for a total of \$475, which continues to be below the gross rent limit of \$500.

Out of Compliance

Low income housing projects are considered out of compliance when the appropriate utility allowance is not used, the utility allowance is not properly calculated, or rents are not reduced for a utility allowance when utilities are paid directly by the tenant. Lack of annual written documentation of utility allowances is considered noncompliance; without proof of the amount of the allowance, there is no way to correctly compute the rent.

Back in Compliance

A unit is considered back in compliance when the rent charged is reduced and correctly reflects the utility allowance. The date of correction is date that the rents correctly reflect the utility allowance.

Example 1: The maximum gross rent is \$500. Beginning on March 1, 2003, the owner charged \$450 rent and a \$75 utility allowance; the total rent is \$525. The rent is \$25 over the ceiling. The error was discovered during a state agency's review on April 13, 2004.

The owner immediately reduces the rent charged to \$425 for rents due beginning on May 1, 2004. The effective date of the new rent, or May 1, 2004, is the date the units are back in compliance.

References

1. Notice 89-6, 1989-1 C.B. 625.
2. Treas. Reg. 1.42-10.